

# GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2013

## FISCAL ANALYSIS MEMORANDUM

[This confidential fiscal memorandum is a fiscal analysis of a draft bill, amendment, committee substitute, or conference committee report that has not been formally introduced or adopted on the chamber floor or in committee. This is not an official fiscal note. If upon introduction of the bill you determine that a formal fiscal note is needed, please make a fiscal note request to the Fiscal Research Division, and one will be provided under the rules of the House and the Senate.]

**DATE:** May 13, 2014  
**TO:** Revenue Laws Committee  
**FROM:** Sandra Johnson and Jonathan Tart, Fiscal Research Division  
**RE:** Omnibus Tax Law Changes

<b>FISCAL IMPACT</b>					
(\$ in millions)					
<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> No Estimate Available					
<b>State Impact</b>	<b>FY 2013-14</b>	<b>FY 2014-15</b>	<b>FY 2015-16</b>	<b>FY 2016-17</b>	<b>FY 2017-18</b>
<i>Corporate Income Tax</i>					
Sales factor		(10.2)	(23.4)	(28.4)	(29.2)
State net loss	0.0	0.0	(5.0)	(5.0)	(5.0)
<i>Tobacco Tax</i>					
Vapor products		1.7	5.0	5.2	5.3
<i>Sales Tax</i>					
Modular and manufactured homes		(6.1)	(6.3)	(6.4)	(6.6)
Prepaid meal plans					
Newspapers	Minimal Fiscal Impact; Gain Less than \$50K				
Retailer contractors	Negative Fiscal Impact, General Fund Impact Unknown				
<b>NET STATE IMPACT</b>	<b>\$0.0</b>	<b>(\$14.6)</b>	<b>(\$29.7)</b>	<b>(\$34.6)</b>	<b>(\$35.5)</b>
<b>Local Impact</b>					
Fair & Flat Tax	Annual reduction of less than \$500K in revenue for counties and \$11.4-\$24.6M in annual loss of funds for cities				
Sales Tax Changes					
<b>NET LOCAL IMPACT</b>		<b>\$0.0</b>	<b>\$0.0</b>	<b>\$0.0</b>	<b>\$0.0</b>
<b>PRINCIPAL DEPARTMENT(S) &amp; PROGRAM(S) AFFECTED:</b> North Carolina Department of Revenue					
<b>EFFECTIVE DATE</b> Varies					
<b>TECHNICAL CONSIDERATIONS:</b> None					
None					

## **BILL SUMMARY:**

### *Corporate Income Tax*

#### **State Net Loss**

The proposal would replace the net economic loss calculation with a State net loss calculation. The primary difference is that there would not be a reduction to losses for non-taxed income.

The current carryforward period of 15 years to utilize a loss for corporate income tax purposes is not changed by this proposal. The proposal is effective January 1, 2015.

#### **Sales Factor**

Under current corporate tax law, most multistate corporations calculate an apportionment percentage that is based on the percentage of property, payroll, and sales in the State. Specifically, the calculation is done by adding the property factor + payroll factor + two times the sales factor and dividing the sum by four. The corporation multiplies its income by that percentage to determine the amount of income subject to tax. The corporate franchise tax base is also apportioned based on this percentage.

The proposal increases the weight of the sales factor in the general apportionment calculation from two times to four times effective with the 2015 tax year. The proposed calculation would be done by adding the property factor + payroll factor + four times the sales factor and dividing the sum by six.

### *Tobacco Tax*

The proposal applies an excise tax to vapor products. The bill modifies G.S. 105-113 creating a definition for vapor products and imposing an excise tax of 5¢ per milliliter of the consumable portion of vapor products. Vapor products are defined as noncombustible products that use a heating element to produce vapor from nicotine in a solution. The consumable product is the part of the vapor product that contains the nicotine liquid solution. This tax is effective February 1, 2015.

### *Sales Tax*

The Tax Simplification and Rate Reduction Act, S.L. 2013-316, increased the rate on modular homes and manufactured homes from 2.5 percent and 2 percent or a \$300 cap to the State sales and use tax rate of 4.75 percent. This change generated \$10.2 million per fiscal year. The Revenue Laws proposal reduces the amount of sales tax that a retailer pays on modular and manufactured homes. Under current law, the retailer remits a sales tax equal to 4.75 percent of the retail price. The proposal modifies the modular and manufacture home sales tax base allowing the retailer to remit a State sales tax, 4.75 percent, on the wholesale price. This sales tax change becomes effective July 1, 2014.

### *Privilege License Tax*

This bill proposes to repeal city and county privilege license taxes (PLTs) replacing PLTs with a flat \$100 per business tax applicable at the municipal level. Effective July 1, 2015.

## ASSUMPTIONS AND METHODOLOGY:

### *Corporate Income Tax*

#### State Net Loss

The estimate for the State net loss provision is based on information from the Department of Revenue regarding audit experience and contested cases resulting from the separate calculation required for North Carolina purposes.

Fiscal impact resulting from the adoption of the federal calculation is not expected to be significant. This is because differences between the state and federal calculation have been reduced due to policy changes that have occurred. Additionally, when a loss is reduced for North Carolina purposes in a carryforward year, a taxpayer has the opportunity to use the loss in a subsequent tax year until the 15-year carryforward period expires. This results in deferral of a loss, not elimination of a loss. Although the fiscal impact is not expected to be significant, Fiscal Research has taken a conservative approach to account for potential impact due to conformity to the federal calculation and to account for timing differences.

#### Sales Factor

The estimate for increasing the sales factor weight in corporate apportionment formula is based on an analysis of corporate tax return data. The fiscal impact was calculated based on the change in franchise and income tax liability that would have occurred had corporations used four times the sales factor in the formula instead of twice the sales factor. The result was adjusted to account for the 5% corporate tax rate in effect starting in 2015. Timing adjustments were made to adjust for the difference in the calendar year and the State's fiscal year.

### *Sales Tax*

The fiscal impact of modifying the modular and mobile home sales tax reduces General Fund availability by \$6.0 million per fiscal year. This portion of the bill becomes effective July 1, 2014. Table 1, provides more information on the methodology used to calculate the fiscal impact of the proposed changes.

<b>Table 1. Fiscal Impact of Modular Home/Mobile Home Sales Tax Modification, FY 2013-14</b>			
	<b>Manufactured Home Sales Tax Base</b>	<b>Modular Home Sales Tax Base</b>	<b>Sales Tax Collections (4.75%)</b>
Current Law	\$ 261.8	\$ 133.3	\$ 18.8
Revenue Laws	\$ 196.4	\$ 80.0	\$ 13.1
<b>Fiscal Impact</b>			<b>\$ (5.64)</b>
Assumed Retail Markup	25%	40%	

Sources: Reference for Business, Operators of Mobile Home Sites <sup>1</sup>
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The legislation makes two sales tax changes, with an unknown or minimal fiscal impact. Removing the sales tax exemption for newspapers sold through vending machines is expected to be positive gain for the General Fund, but the estimate fiscal impact is minimal (less than \$50,000). The fiscal impact of modifying the sales tax base for retailer-contractors is expected to be negative, but the magnitude of the impact is unknown.

#### *Vapor Products*

Based on industry information, Fiscal Research estimates that the nickel per milliliter tax on vapor products will generate \$5.1 million per fiscal year. A similar proposal in South Carolina was estimated to generate \$2.5 million per fiscal year.

According to Nielson data, the e-cigarette industry grossed \$1.8 billion in 2013. Roughly 45 percent of e-cigarette sales occur online, with the remainder occurring through traditional channels such as convenience stores. Lorillard's vapor product, Blu, is an industry leader representing 45 percent of all e-cigarette convenience store purchases. Despite the decline/leveling off of traditional tobacco products, the e-cigarette sector is expected to continue to grow with refillable cartridges playing a key role.

Effective February 1, 2015, the fiscal estimate assumes that between 2.9 percent and 3.4 percent of all e-liquid product sales occur in North Carolina, and that three billion milliliters of e-juice are sold nationally. Apportioning this amount to NC, between 87 million and 102 million milliliters of e-juice is sold in the state annually. A nickel per milliliter excise tax on e-juice would generate between \$4.4 million and \$5.2 million in General Fund Revenue per fiscal year.

#### *Privilege License Tax*

Effective July 1, 2015, enacting this bill would result in an \$11.4 million to \$24.6 million loss for municipalities. The estimated loss to counties is less than \$500,000 per fiscal year. To estimate the fiscal impact of replacing the current privilege license tax (PLT) system with a \$100 per business, per location tax, Fiscal Research utilized business information from the North Carolina League of Municipalities and the U.S. Census County Business Patterns database, alongside population information from the North Carolina Department of Revenue.

The estimated lower bound losses of \$11.4 million assume that all cities levy the maximum \$100 per business on all businesses available. The estimated upper bound loss of \$24.6 million assumes that cities either reduce their privilege license tax collections (based on the \$100 per business tax) or hold their current privilege license tax collections constant, choosing the lesser of the two options.

### **SOURCES OF DATA:**

NC Department of Revenue

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<sup>1</sup> Source: <http://www.referenceforbusiness.com/industries/Finance-Insurance-Real-Estate/Operators-Residential-Mobile-Home-Sites.html>

North Carolina League of Municipalities: The League of Municipalities surveyed its members in 2013 on the number businesses currently paying a privilege license tax. Members responded to the survey, reporting the number of companies reflected in the 2009-10 fiscal year PLT collections. Of the 310 cities that levied a PLT tax in FY 09-10, the League received information on the number of businesses taxed from 120 cities.

U.S. Census County Business Patterns database: NS1100A2: 2011 Nonemployer Statistics: Geographic Area Series: Nonemployer Statistics for the US, States, Metropolitan Areas, and Counties: 2011; CB1100A11: 2011 County Business Patterns: Geography Area Series: County Business Patterns

Minnesota Department of Revenue

South Carolina Board of Equalization

Nicotine and Science Policy, “New Estimates Double Size of US E-cigarette Market; Increasing Importance of Refillable and Modified Devices.” Available at: <http://nicotinepolicy.net/gerry-stimson/1317-wells-fargo-march-2014>

**TECHNICAL CONSIDERATIONS:** None